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240625—40——1

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

HORSESHOE LEASE SYNDICATE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above entitled cause on March 26, 1940.

OPINIONS BELOW

The unpublished memorandum opinion of the Board of Tax Appeals is printed in the record at pages 13 to 24, inclusive. The opinion of the Circuit Court of Appeals is reported in 110 F. (2d) 748.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 26, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the group associated together and doing business under the name of Horseshoe Lease Syndicate was, during the taxable year involved, an "association" within the meaning of Section 1111 (a) (2) of the Revenue Act of 1932 and as such subject to income tax as a corporation during the year.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations involved are printed in the Appendix, *infra*, pp 19–27.

STATEMENT

The Horseshoe Lease Syndicate, hereafter sometimes referred to as the taxpayer, filed a Partnership Return of Income for the year 1932, disclaiming any liability for federal income tax. (R. 13, 85, 127–128.) Thereafter the Commissioner of Internal Revenue determined that during the year involved the Syndicate was doing business as an association within the meaning of Section 1111 (a) (2) of the Revenue Act of 1932, and as such was subject to income tax as a corporation. He therefore asserted the deficiency in a tax here in contro-

versy (R. 6, 13–14, 146–150), and a petition for review was filed with the United States Board of Tax Appeals (R. 6–9). The proceeding was submitted to the Board upon a stipulation of facts (R. 81–151) which was incorporated by reference in the findings of fact made by the Board (R. 14), and upon oral testimony adduced at the hearing before the Board (R. 60–80). In its memorandum opinion the Board summarized the facts as follows (R. 14–23):

On January 28, 1931, W. J. Brightwell, and others, the joint owners and claimants of an interest in a tract of about 65 acres of land known as the Brightwell place located in Rusk County, as parties of the first part, and J. Edgar Finley, P. T. Fullwood, and the Patterson Drilling Company, a Texas corporation, as parties of the second part, entered into an agreement relating to that land. Such agreement provided, *inter alia,* that after the survey and platting of the land the first parties would execute an oil and gas lease to the second parties covering a parcel 600 feet by 660 feet in the tract subject to a ⅛th royalty and a yearly rental of $1 per acre; that the second parties would organize a syndicate having 350 units, par value of $100 each, for the purpose of drilling wells on the 600 foot by 660 foot tract, and marketing the products therefrom, and would, as balance of the consideration for said lease, deliver 35 of such units to the first parties; that the second parties would commence drilling within a specified time, complete and

equip a well at their own expense, and under certain conditions would drill and equip a second well; and that an escrow agent would deliver the executed lease to the second parties after they had spudded in the first well. Such agreement was executed and acknowledged by all of the necessary parties thereto and was recorded in the deed records of Rusk County, Texas. Due to certain conditions which arose, some of the provisions of that agreement, immaterial here, were not carried out. (R. 14–15.)

Pursuant to the agreement of January 28, 1931, W. J. Brightwell and others, as lessors, executed and delivered in escrow an oil and gas lease, dated February 9, 1931, to J. Edgar Finley, P. T. Fullwood, and the Patterson Drilling Company, as lessees. The lease was for a term of five years and as long thereafter as oil, gas, or other mineral was produced from the leased premises. The lease was duly signed and acknowledged by the proper parties and was duly recorded on April 25, 1931, in the deed records of Rusk County, Texas. The lease embraced the northwest corner, described by metes and bounds, of the Brightwell 65 acre tract, and under the terms thereof the lessors reserved a royalty of 1/8 of the oil produced and saved and certain royalties on gas and other minerals. The lessees were, under the agreement of January 28, 1931, obligated to drill and equip at least one well. (R. 15.)

On May 16, 1931, Finley, Fullwood, and W. A. Patterson, the latter as an officer of the Patterson

Drilling Company, filed, in Rusk County, Texas, under the "Assumed Name Law of Texas," a certificate of ownership under the assumed name of "Horseshoe Lease Syndicate." That name was adopted to identify the lease. (R. 15–16.)

Finley, Fullwood, and the Patterson Drilling Company divided their joint interest in the lease into 350 fractional parts, and pursuant to the agreement of January 28, 1931, they conveyed 35/350ths interests to the above mentioned original lessors, which interests were to be non-assessable for any expenses incident to the drilling of the wells or the marketing of oil or gas produced therefrom. Also, prior to January 1, 1932, and as the owners thereof, they sold numerous undivided fractional interests in the lease for $100 for each 1/350th interest for the purpose of financing the drilling and equipping of one well, retaining a large number of such interests for themselves. They executed and delivered an assignment for each such fractional interest in the following form (R. 16–21):

ASSIGNMENT OF OIL AND GAS LEASE

> WHEREAS, J. Edgar Finley, P. T. Fullwood, Patterson Drilling Co. (a corporation), are the owners of oil, gas and mining leases covering the following described tract of land situated in Rusk County, Texas, to-wit:
>
> * * * * *
>
> NOW THEREFORE, * * * the undersigned, the present owners of the said lease

and all rights thereunder or incident thereto, do hereby bargain, sell, transfer, assign and convey unto ---------- an undivided ---------- interest in and to all of the right, title and interest of the original lessee, * * *.

* * * * *

1. In consideration of the grantee, herein above named, purchasing this assignment and the leasehold property herein conveyed, J. Edgar Finley, P. T. Fullwood, Patterson Drilling Co. hereby contract and agree to do the following things, to-wit:

(a) To drill at their own cost and expense, one well on the lease above described; said well to be drilled to a depth of 3,700 feet unless granite in solid formation in its regular place is encountered at a lesser depth and in such quantities as to render it impenetrable; or unless oil or gas in paying quantities be encountered at a lesser depth. The said owners shall have the right to drill an additional well on said lease, if in their judgment it appears to be to the best interests of the owners of this lease; and the expense of drilling and equipping such additional well and all equipment necessary for said lease, shall be paid out of the funds received from the sale of oil or gas produced from said lease; it being specifically understood that J. Edgar Finley, P. T. Fullwood and Patterson Drilling Company only contract to drill one well; but they may drill an additional well, if in their judgment it appears to be to the best interests of all the owners

of said lease. J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co. (a Corporation), reserve the right, and they are also expressly empowered to borrow money for the purpose of drilling and equipping such additional well, and pledge and encumber by giving a lien thereon, said lease, in whole or in part, for the purpose of securing the payment of all money so borrowed.

2. In consideration for J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co. doing the things set out and stipulated in the paragraph numbered "1" above and in subdivision "a" thereof, the owner and holder of this assignment agrees that J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co. shall operate said lease above described for the benefit of all the parties interested in said lease; and shall collect for all pipe line runs of oil from said lease, and likewise, collect all money to be received from the sale of gas from said lease; and after having paid all proper operating expenses, shall distribute and pay to the owners of said lease, such proportion of the remaining proceeds as their respective interests in said lease shall entitle them to receive, according to the proportionate part of said lease they then own.

3. It is further agreed by the parties hereto that the undersigned J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co. shall have the power at any time, in their discretion, to sell and dispose of all or any part of the above described lease-hold prop-

erty on such terms and conditions and at such price as in their judgment shall seem best and proper, and the said J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co., as a part of this sale, hereby reserve the power and right to make such sale or sales of all or any part of said property, and to transfer, convey, and assign the same, and as an incident thereto, they shall execute and deliver all such written instruments as may be necessary or required to properly and legally convey and assign good title thereto, to the purchaser or purchasers thereof. And the said J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co. are, for the purpose of making such sale or sales, fully and completely authorized and empowered to sign the name of the grantee herein to any and all instruments that may be necessary to be executed and in all other respects to act in said grantee's place and stead as said grantee's attorney in fact, executing, acting and delivering such written instruments and muniments of title the same as said grantee could do if personally present and executing and delivering the same in person, and in accepting and buying this assignment, the grantee herein does so with the express understanding that the said J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co., as above stipulated and provided, may act as attorney in fact for said grantee as above set out, the said grantee hereby ratifying and confirming all such

lawful acts as the said J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co. shall do or cause to be done by virtue thereof. It is expressly understood and agreed, however, that when said leasehold property or any part thereof shall have been sold as herein provided, the said J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co. shall receive and distribute to each of the parties owning an interest in said lease-hold property or any part thereof, such proportionate part of the net proceeds derived from said sale as each of said parties shall be entitled to receive, according to the interest each of the parties respectively owns in said lease-hold property or part thereof. It is further agreed by and between the grantor and grantee herein that this instrument is to be effective as an assignment, transfer and conveyance of the interest herein described only when signed and acknowledged by both the grantor and grantee herein.

J. Edgar Finley, P. T. Fullwood and Patterson Drilling Co. hereby reserve the right to pay all money due to the owner of the interest hereby assigned to the grantee herein unless they shall have received notice that the interest hereby assigned has been sold and assigned by the grantee herein to some other person. All subsequent assignees of the interest herein assigned shall take said interest subject to and be bound by the terms, covenants, agreements and reservations herein contained.

IN WITNESS WHEREOF, the undersigned owner and grantor has signed and sealed this instrument this ____ day of _____ A. D. 19__.

_____

_____

PATTERSON DRILLING CO.

_____ [SEAL]

Grantee

By _____

Grantors.

There was no restriction on the conveyance or reassignment by the assignees of such fractional leasehold interests and in fact many of such interests were reassigned by the original assignees and in such instances the operation of the leased premises was continued uninterrupted by such transfers which were made subject to the agreement set out in the original assignments. (R. 21.)

Finley, Fullwood, and the Patterson Drilling Company secured a drilling permit issued to the Horseshoe Lease Syndicate by the proper authorities of the State of Texas. Pursuant to their agreement with the lessors and the agreement contained in the assignment to each purchaser of a fractional interest, they drilled and equipped the first well on the leased premises at their own expense. The driller was paid in part by assignment by Finley, Fullwood, and Patterson Drilling Company of a fractional interest in the lease out of their remaining joint interest therein, and the equipment was paid for by each contributing the sum of $2,250 out of his own funds. A second well was drilled in

1933, payment for which was made out of the proceeds of oil and gas therefrom. (R. 21.)

During a period including the taxable year, Finley, Fullwood, and Patterson, the latter as an officer and on behalf of the Patterson Drilling Company, operated the leased premises and arranged for the sale of the oil produced therefrom and the distribution of the proceeds therefrom in accordance with the terms of their agreement with the lessors and their separate agreements with each purchaser of a fractional interest. Such operations were on behalf of the various co-owners of fractional interests in the leased premises, including themselves, and no sale of that lease nor purchase of any additional lease was made by Finley, Fullwood, and the Patterson Drilling Company on behalf of such owners during the taxable year. Finley, Fullwood, and Patterson kept their records at various places and used convenient mailing addresses until they employed an accountant in June, 1931, and thereafter their books and records were kept in that accountant's office. There was no declaration of trust in connection with the Horseshoe Lease Syndicate or the leased premises, but to avoid the necessity of Finley, Fullwood, and Patterson all signing checks, those three designated Fullwood as trustee to sign such checks. (R. 21–22.)

Pursuant to a division order covering a 7/8ths interest in the leased premises and signed by D. M. Finley, J. Edgar Finley, P. T. Fullwood, and the

Patterson Drilling Company by W. A. Patterson, the monthly checks from the pipe line company for oil purchased were made payable to those four parties, who endorsed such checks, which were then deposited in the Citizens National Bank of Henderson, Texas, in an account captioned "Horseshoe Lease Syndicate". After deducting the operating expenses, including the salaries paid to the auditor, a lease superintendent, and workman, the monthly net proceeds from the oil runs were distributed *pro rata* each month to the owners of fractional interests by checks drawn on the bank account of the "Horseshoe Lease Syndicate", such checks being signed, "Horseshoe Lease Syndicate by P. T. Fullwood, Trustee". No surplus in excess of anticipated expenses was ever maintained. (R. 22–23.)

During 1932 there were numerous owners of fractional interests in the leased premises, including Finley, Fullwood, and the Patterson Drilling Company, the latter three having retained a large number of unsold fractional interests therein. Certificates or evidences of their interests other than the above mentioned assignments and the conveyances were never issued to them, or any of them. There was no limitation upon the personal liability as tenants in common, of the various co-owners of the lease, except as to the original lessors as the Owners of 35/350ths interests therein. They never held any meetings, had no by-laws, paid no rent for office space, never borrowed any money, never made any declaration of trust, and they were never

consulted with reference to the operation of the leased premises, except that written consent for the drilling of the second well was obtained from each owner of a fractional interest in the lease. (R. 23.)

The Board concluded, on the basis of the foregoing statement, that the Horseshoe Lease Syndicate was not doing business as an "association" during the year 1932 within the meaning of the statute and that it was therefore not taxable as a corporation. (R. 23–24.) The Circuit Court of Appeals affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the question whether the Horseshoe Lease Syndicate was taxable as a corporation during the year involved is a question of fact, and in failing to hold that the question is a question of law.

2. In holding, on its assumption that the question is one of fact, that the Board of Tax Appeals found as a fact that the Syndicate was not an association taxable as a corporation for the year involved.

3. In holding, on its assumption that the question is one of fact, that the evidence supports the Board's finding that the Syndicate is not an association taxable as a corporation.

4. In failing to hold as a matter of law that the Horseshoe Lease Syndicate was, during the year

1932, doing business as an association as that term is used in Section 1111 (a) (2) of the Revenue Act of 1932, and as such subject to the federal income tax imposed on corporations.

5. In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

The decision below conflicts in several respects with decisions in other circuits as well as with decisions of this Court. Moreover, the question presented is an important one in the administration of the revenue acts because the device employed in this case is common in the financing and development of oil properties, and the question presented is of frequent recurrence.

1. The decision below is in substantial conflict with *Thrash Lease Trust* v. *Commissioner*, 99 F. (2d) 925 (C. C. A. 9th), certiorari denied, 306 U. S. 654. There an arrangement similar to the arrangement in the instant case was entered into for the development and exploitation of an oil and gas lease in Texas. The lease was assigned to one Gordon Macmillan, as trustee, and the development of the property and assignment of interests were carried out in much the same manner as those details were carried out in the instant case. Percentage interests were assigned to many persons, some of the interests purporting to be interests in the oil and gas and some purporting to be interests in the lease. There were some variations in the

terms of the assignments. All were transferable and some actually were transferred. All business transactions and operations of the well were conducted, and the net proceeds from operation were distributed by Gordon Macmillan and his father in much the same manner as the business of the Horseshoe Lease Syndicate and the distribution of its profits were carried out by Finley, Fullwood, and the Patterson Drilling Company. In that case the court held that the group operating the lease involved constituted an "association" taxable as a corporation.

2. The decision below conflicts with the principles announced by this Court in *Morrissey* v. *Commissioner*, 296 U. S. 344; *Swanson* v. *Commissioner*, 296 U. S. 362; *Helvering* v. *Combs*, 296 U. S. 365; *Helvering* v. *Coleman-Gilbert*, 296 U. S. 369; and *Burk-Waggoner Assn.* v. *Hopkins*, 269 U. S. 110. It has been clearly established that a cooperative business enterprise qualifies as an "association" where there is centralized management and where the beneficial interests are transferable without affecting the continuity of the enterprise. *Morrisey* v. *Commissioner, supra*, at 356–360. And it is equally clear that other corporate characteristics such as a voice in the management of the group affairs by the participants,[1] formal evidence of

[1] *Hecht* v. *Malley*, 265 U. S. 144; *Morrissey* v. *Commissioner*, 296 U. S. 344, 358; *Helvering* v. *Combs*, 296 U. S. 365, 368.

beneficial interest,[2] election of officers, formal meetings, by-laws and the like,[3] while serving to emphasize the corporate analogy in individual cases, are not essential to classification of the group as an association. Nor is it material that the enterprise may be limited to a single project such as the operation of one oil well.[4] And, the classification of an enterprise as an association "is not affected by the fact that, under the law of a particular State, the association cannot hold title to property, or that its shareholders are individually liable for the association's debts, or that it is not recognized as a legal entity." *Burk-Waggoner Assn.* v. *Hopkins*, 269 U. S. 110, 114.

In the instant case all of the essential corporate attributes are present. The lessees of the oil and gas lease and the holders of participating interests were "associates." They had entered into a joint enterprise for the transaction of business. Cf. *Morrissey* v. *Commissioner*, 296 U. S. 344, 356. The participating interests were freely assignable, and actually were assigned, thus assuring continuity of the life of the enterprise. And management of group affairs was, by reason of the undertakings, reservations, and powers granted to the lessees or operators by the terms of the purported assignment

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[2] *Morrissey* v. *Commissioner*, 296 U. S. 344, 358; *Helvering* v. *Coleman-Gilbert*, 296 U. S. 369.

[3] *Swanson* v. *Commissioner*, 296 U. S. 362, 364; *Helvering* v. *Combs*, 296 U. S. 365, 368; *Helvering* v. *Coleman-Gilbert*, 296 U. S. 369, 372–373.

[4] *Helvering* v. *Combs*, 296 U. S. 365, 368.

of undivided interests in the oil and gas lease, centralized in the three promoters.

Since all of the essential corporate characteristics were present in the instant case the decision below holding that the Syndicate is not an association taxable as a corporation is in substantial conflict with the decisions of this Court in *Burk-Waggoner Assn.* v. *Hopkins, supra; Morrissey* v. *Commissioner, supra; Swanson* v. *Commissioner, supra; Helvering* v. *Combs, supra;* and *Helvering* v. *Coleman-Gilbert, supra.*

Moreover, the decision below is in conflict with a number of cases in other circuits to the extent that it fails to apply the principles established by the foregoing decisions of this Court. *Monrovia Oil Co.* v. *Commissioner,* 83 F. (2d) 417 (C. C. A. 9th); *Wholesalers Adjustment Co.* v. *Commissioner,* 88 F. (2d) 156 (C. C. A. 8th); *Bert* v. *Helvering,* 92 F. (2d) 491 (App. D. C.); Title Insurance & Trust Co. v. *Commissioner,* 100 F. (2d) 482 (C. C. A. 9th); *Wellston Hills Syndicate Fund* v. *Commissioner,* 101 F. (2d) 924 (C. C. A. 8th).

3. Whether the Horeshoe Lease Syndicate is an association within the statutory definition was treated by the court below as a question of fact, and it limited its review simply to an examination of whether there was "substantial evidence to support" what it described as "the finding" of the Board of Tax Appeals. In so limiting the scope of review, the decision below is in direct conflict with a number of decisions which treat the ques-

tion as one of law, and in each one of which the judgment of the lower tribunal was reversed. E. g. *Commissioner* v. *Vandegrift Realty Co.*, 82 F. (2d) 387 (C. C. A. 9th); *Commissioner* v. *Highlands E.-L. Subd., etc.*, 88 F. (2d) 355 (C. C. A. 7th), certiorari denied, 302 U. S. 691; *United States* v. *Trust No. B. I. 35*, 107 F. (2d) 22 (C. C. A. 9th); *Helvering* v. *Combs*, 296 U. S. 365.

4. This case involves an issue of considerable importance in the administration of the income tax statutes. The question presented is a frequently recurring one, since the method of operation adopted by the parties interested in this lease is used extensively throughout the oil producing sections of the country. Many cases are pending before the Bureau of Internal Revenue, the Board of Tax Appeals, and the courts involving the same question with respect to similar joint undertakings. It is important, therefore, that this Court settle the application of established principles to this type of case.

CONCLUSION

Wherefore, it is respectfully submitted that this petition should be granted.

FRANCIS BIDDLE,
Solicitor General.

JUNE, 1940.